April 2001

Georgia

Georgia is of strategic importance as a potential transit state for oil and gas from the Caspian Sea region to Western markets.

Information contained in this report is the best available as of April 2001 and is subject to change.

GENERAL BACKGROUND

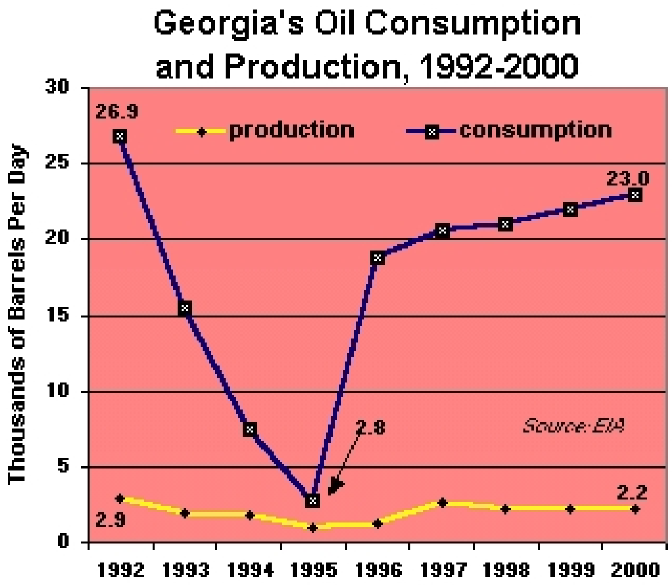
After its independence from the Soviet Union in 1991, Georgia was beset by civil conflict and political turmoil, including the overthrow of the country's first democratically elected president and separatist struggles in Abkhazia (northwest Georgia) and South Ossetia (north central Georgia). A Russian-enforced cease-fire in 1994 brought an end to the conflict in Abkhazia, and both conflicts have been dormant for several years now, but Russian troops remain stationed in Abkhazia. Russia's war in Chechnya has led to fighting along the Georgian-Chechen border, and the dispute over the withdrawal of Russian forces from Georgian territory and Russia's accusation of Georgian support for Chechen rebels has strained Georgian-Russian relations.

Georgia's economy, already reeling from the loss of Soviet subsidies after independence, was severely damaged by the Abkhazia and South Ossetia civil conflicts. Hyperinflation in the early 1990s reached 7,000% per year by 1994, and by 1995, Georgia's gross domestic product (GDP) had fallen to 20% of 1990 levels. Since then, however, GDP has leveled off and, with the help of the International Monetary Fund (IMF) and World Bank, a recovery has begun. Georgia's currency, the lari, was introduced in September 1995 and has remained relatively stable with the backing of an IMF stabilization fund. Inflation, estimated at 4.6% in 2000, has been brought under control, and GDP growth has resumed, although it has been moderated (1.9% in 2000) by the lingering negative effects of Russia's August 1998 financial crisis.

Georgia continues to experience large budget deficits due to a failure to collect tax revenues, and the country is burdened by a growing foreign debt problem. Much of Georgia's foreign debt is to Russia and Turkmenistan for fuel supplies; Georgia's only sizable internal energy resource is hydropower, and a drought in 2000 reduced the country's hydropower potential. However, Georgia privatized its electricity distribution network in 1998, and deliveries are improving, despite a crisis in January 2001 due to a cutoff of Russian gas supplies for electricity. Georgia is pinning its hopes for long-term economic recovery on the development of an international energy transportation corridor via Tbilisi and the key Black Sea ports of Poti and Batumi, as well as foreign investment in the country's own nascent oil industry.

OIL

Georgia has limited oil resources, but with investment increasing and active exploration underway, both along Georgia's Black Sea coast and onshore, the country's domestic production is set to rise dramatically in coming years. In 2000, Georgia produced 2,200 barrels per day (bbl/d) of oil, and with the country's consumption of 23,000 bbl/d projected to increase as Georgia continues its recovery from civil strife in the mid-1990s, Georgia will need to develop its oil sector to meet domestic needs.



Georgian authorities have estimated that $453 million is to be invested in oil and gas exploration and production in Georgia by nine joint ventures between 2001 and 2005. The joint ventures are conducting operations in a number of blocks, including Ninotsminda, Manavi, Rustavi Kartli, Samgori, Patardzeuli, Mtiani Kakheti, Mirzaani, Taribana, Patara Shiraki, Nazvrebi, Georgia's Black Sea shelf, Supsa, Chaladidi, and Shromisubani. While the majority of companies are prospecting for oil and gas, several companies already have discovered oil fields of commercial value and are actively developing those deposits. Some forecasts suggest that Georgia may produce up to 20,000 bbl/d in 2001, with production increasing to two to three million tons per year (40,000-60,000 bbl/d) by 2005.

In July 2000, Frontera Eastern Georgia, a Georgian-American joint venture, began extracting 120 tons of oil per day (800 bbl/d) from the Taribana field in Kakhetia. According to specialists, the Taribana deposit could begin producing about 400 tons per day (2,666 bbl/d) in the near future. The Taribana field, the first of Frontera's development projects, which contains an estimated 1 billion barrels of oil equivalent. Frontera holds 100% of the foreign company operating interest in the production-sharing agreement and is in partnership with Saknavtobi, the Georgian state oil company.

CanArgo-Georgia, a Georgian-British oil company, has discovered commercial oil reserves in Georgia in the Ninotsminda field. The company, whose activities are conducted through its wholly owned subsidiary, Ninotsminda Oil Company Ltd., is planning to produce 150,000 tons of oil (3,000 bbl/d) in 2001, as well as to drill four deep exploratory wells and to continue with geological survey work. Saknavtobi and Anadarko (U.S.) already have worked out a package of production-sharing agreements on the Black Sea shelf, where exploration engineers have discovered roughly 580 million tons of oil (42.5 billion barrels), including about 200 million tons (14.7 billion barrels) offshore. In March 2001, Anadarko completed its first stage of exploration, with plans to drill the first test boreholes as early as the summer of 2001. Georgian officials have said that Anadarko may invest up to $1 billion to develop the offshore oil fields.

Georgia has negotiated several production-sharing agreements and joint ventures in the Kura Basin east of Tbilisi, as well as in the Black Sea region in western Georgia. In August 2000, Saknavtobi and the German company GWDF International signed an agreement to develop the Chaladidi, Supsa, and Shromisubani fields in western Georgia. Kakheti Oil Ltd., the local operating company managed by Ramco Energy through its 1998 agreement with Saknavtobi, drilled its first well onshore in Kakhetia at the end of 2000.

Refining

Georgia has a 106,000-bbl/d refinery at Batumi and a smaller, 4,000-bbl/d refinery at Sartichala, the Georgian-

American Oil Refinery (GAOR). Georgia has awarded a $250-million contract to Japan's Marubeni Corporation and JGC Corporation to expand and modernize the Batumi refinery, and Georgia is working with the EBRD to finance the reconstruction of the Gardabani-Batumi pipeline, which has transported oil to the refinery at Batumi.

In November 2000, CanArgo Energy Corp. purchased an additional 38% in the GAOR, giving it a controlling interest in the refinery, which is situated in proximity to CanArgo's producing Ninotsminda field and Tbilisi. CanArgo intends to expand the capacity of the refinery, as well as broaden the refinery's product stream to include high-octane gasoline. Georgia also has awarded Frontera the right to construct a new refinery near Tbilisi as part of its production-sharing agreement.

Oil and Gas Transit
Georgia's importance in world energy markets stems from its geographic location as a growing transit center for oil and gas from the Caspian Sea region. Georgia is part of the designated Eurasian Transport Corridor (TRACECA) to bring oil, gas, and other products from the Caspian/Caucasus region to Europe. In addition to transporting the "early oil" from the Azerbaijan International Operating Company (AIOC) through its Black Sea port at Supsa, Georgia is playing a key role as a transit state for the planned 1-million bbl/d Main Export Pipeline (MEP) that will carry Caspian oil from Baku, Azerbaijan, via Tbilisi to the Turkish Mediterranean port of Ceyhan and on to world markets.

NATURAL GAS

Georgia has small natural gas resources, leaving it almost entirely dependent on foreign suppliers. Georgia's natural gas production in 1999 was 2.1 billion cubic feet (Bcf), which Georgian leaders hope to increase in coming years with foreign investors helping to develop the country's gas deposits. In January 2001, CanArgo-Georgia began work on drilling a new gas well at the Ninotsminda gas deposit in Georgia, which has estimated gas reserves of less than 706 Bcf.

Georgia's natural gas consumption in 1999 was 41 Bcf, far exceeding the country's natural gas production capacity. In addition, Georgia's inability to pay its suppliers has limited the country's consumption, as both Russia and Turkmenistan have cut off gas to Georgia for lack of payment. Georgia's 1999 natural gas consumption was less than 25% of the country's 1992 natural gas consumption (177 Bcf).

Turkmenistan claims that Georgia still owes it $400 million for past natural gas supplies, and as a result Turkmenistan has ceased gas shipments to Georgia, leaving Russia Georgia's sole gas supplier. This tenuous situation led to a crisis when, on January 1, 2001, Russia's Inneftegazstroi, part of the Gazprom group, halted supplies of natural gas to the Tbilisi State Regional Power Plant, causing blackouts throughout Tbilisi. Representatives of AES (U.S.), which runs the electricity distribution network in the Tbilisi area, said that the cutoff violated their contract with Inneftegazstroi, which supplied 1,000 cubic meters of gas at a cost of $41 (compared with $53 per 1,000 cubic meters in a recent contract between the Georgian Energy Ministry and Itera, the international energy corporation). Gas shipments to the power plant resumed on January 4th by Itera on a temporary basis until the problem with Inneftegazstroi was solved.

In an effort to restructure Georgia's gas-distributing pipelines and to receive guarantees of future gas supply at a firm price, Georgian authorities previously have offered Itera the option of taking part in the privatization of Tbilgaz, the state company controlling Georgia's gas transportation pipelines. In July 2000, Itera had offered $1.5 million for 75% in Tbilgaz, and was prepared to undertake rescheduling of the company's debts, but Georgia postponed the official announcement of the privatization tender. On October 4, 2000, Itera executives said that the company preferred only to take part in a consortium of a few investors to buy out Tbilgaz. Negotiations on a new privatization scheme are continuing.

COAL

Georgia's coal industry, already small by world standards in 1991, has become even smaller since the country's independence. Between 1992 and 1999, Georgia's coal consumption plummeted 97%--from 480,000 short tons in 1992 to just 15,000 short tons in 1999. Similarly, the country's domestic coal production has witnessed a drastic 95% reduction, from 220,000 short tons in 1999 to 11,000 short tons in 1999. Nevertheless, the country's coal industry has rebounded somewhat from the effects of the separatist conflicts in the early and mid-1990s, and since 1997, Georgia's coal production and consumption actually have increased, albeit slowly.

ELECTRICITY

The weakness of Georgia's power sector is one of the biggest obstacles to the country's economic growth. Although Georgia technically generates more electricity than it consumes (8.0 billion kilowatt-hours--Bkwh--

generated in 1999, compared to 7.1 Bkwh consumed in the same year), power outages are a daily occurrence in much of the country, and parts of Georgia do not receive any electricity at all. Georgia's total electricity demands have been estimated at nearly twice the amount that is actually generated, and the Georgian Energy Ministry estimates that 40% of all power that is generated is wasted due to equipment and maintenance problems in the transmission sector. In addition, the power sector is plagued by frequent customer non-payment, as well as the country's dependence on foreign gas supplies.

To meet some of its power needs, Georgia imports electricity from both Armenia and Russia. Georgia has ran up large electricity debts to both countries; at the end of 2000, Georgia owed Armenia approximately $4.4 million and Russia approximately $50 million for past electricity supplies. The debts have stopped growing since Georgia privatized the Telasi electricity distribution network in 1998. AES purchased 75% of Telasi, which serves the Tblisi area, for $25.5 million, and made a commitment to pay $10 million of Telasi's debt and $80 million in investment to provide consumers with 24-hour electricity.

Power Shortages

Georgians continue to suffer from power shortages, and a drought in the summer of 2000 meant that hydropower plants, which generate nearly 80% of the country's electricity, seriously depleted hydropower reservoirs, dashing hopes that the winter of 2000-2001 would be the first without periodic electricity disruptions. Tbilisi residents were enraged when Georgian officials announced they would only receive six to eight hours per day of electricity during the winter, but most parts of the Georgian capital had electricity only two hours per day on average. Residents use kerosene for heating.

Russia's decision to cut off gas supplies to power-producing units at Tbilisi State Regional Power Plant on January 1, 2001, following the summer drought, triggered a full-fledged energy crisis in Georgia and further soured Georgian-Russian relations. Georgia's Foreign Ministry said that the shut-off came despite prepayment for January shipments. Russia resumed natural gas supplies to the Georgian capital after a three-day break in service during which electricity supplies in Georgia were cut by up to 80%.

In addition, in an effort to boost its electricity supply, Georgia had rejoined the Russian power grid in November 2000, but on January 25, 2001, Russia's electricity monopoly UES reduced its power deliveries to Georgia because of Georgia's electricity debts. UES cut power deliveries from 2.5 million kilowatt-hours to 1 million kilowatt-hours. Russia has since increased power supplies to Georgia with an eye towards exporting electricity to Turkey via Georgia. Russian and Turkish officials have been in negotiations towards concluding an electricity export deal.

Privatization

In an effort to resolve the problems in the power sector, Georgia is actively privatizing Sakenergo, the state energy and power company. With support from the World Bank and the EBRD, most of Georgia's hydro and thermal generation units have been restructured as joint-stock companies, and the Georgian Ministry for the Management of State Property is proceeding with privatization in three stages.

In the first stage, AES purchased 75% of the Tbilisi State Regional Power Plant (Gardabani), as well as a 75% share of the Relasi distribution power company in Rustavi, and a 25-year management contract for the Khrami I and II hydroelectric power stations (223-megawatt (MW) combined capacity). The second stage will offer 75% of the shares in the Kutaissky distribution company (Kalasi), and management of 100% of the shares in 5 hydroelectric plants (Ladjanuri, Tkibuli, Shaori, Gumati, Rioni), while the third offer will contain 75% of the shares in the remaining 58 distribution companies.

Investment/Renovation in Hydropower Projects

Georgia is courting foreign equity participation for both new capacity and rehabilitation hydropower projects. Georgia has a substantial amount of untapped hydro energy that could be exploited, with plans already made to build two new hydroelectric plants on the Rioni River (the 250-MW Namakhvani and the 100-MW Zhoneti), as well as a plan to build the 40-MW Minadze station on the Kura river.

Dengen Kaihatsu (Japan) has announced its readiness to invest both in construction of new hydroelectric stations in Georgia and restoration of the old ones, and in February 2001, Chinese and Georgian officials signed an agreement on the construction of a hydropower station near the Georgian-Russian border, in the Pankisi Gorge, that will meet the electricity needs of the eastern Kakheti region.

In addition, in November 2000, Georgia announced a tender for the rehabilitation of the Inguri hydropower station, the country's largest. The project, which will cost an estimated $62 million, will boost capacity at the plant to 1,300

MW from 400-450 MW currently The EBRD will provide $39 million in the form of a long-term credit, with the EU and Japan providing grants totaling $10 million, and Georgia financing the remainder.

COUNTRY OVERVIEW

President: Eduard Shevardnadze (previously elected chairman of the Government Council March 10,1992; Council has since been disbanded; previously elected chairman of Parliament Oct. 11,1992; president since Nov. 26, 1995; re-elected to a five-year term on April 9, 2000)
Minister of State: Gia Arsenishvili
Independence: April 9, 1991 (from Soviet Union); Independence Day: May 26 1991
Population (7/00E): 5.0 million
Location: Southwest Asia on Black Sea between Armenia, Azerbaijan, Russia, and Turkey
Size: 26,911 square miles, slightly smaller than South Carolina
Major Cities: Tbilisi (capital), Batumi, Poti, Rustavi
Language: Georgian 71% (official), Russian 9%, Armenian 7%, Azeri 6%, other 7% (includes Abkhaz, official in Abkhazia)
Ethnic Groups: Georgian 70.1%, Armenian 8.1%, Russian 6.3%, Azeri 5.7%, Ossetian 3%, Abkhaz 1.8%, other 5%
Religion: Georgian Orthodox 65%, Muslim 11%, Russian Orthodox 10%, Armenian Apostolic 8%, unknown 6%

ECONOMIC OVERVIEW

Finance Minister: Zurab Nogaideli
Economics and Industry Minister: Vano Chkhartishvili
Currency: Lari
Market Exchange Rate (3/9/2001): US$1=2.08 Lari
Nominal Gross Domestic Product (GDP) (2000E): $3.0 billion; **(2001E):** $3.1 billion
Real GDP Growth Rate (2000E): 1.9%; **(2001E):** 2.1%
Inflation Rate (Change in Consumer Prices, December 1999 - December 2000): 4.6%; **(2001E):** 4.7%
Official Unemployment Rate (2000E): 6.3%; **(2001E):** 4.7%
Current Account Balance (2000E): -$181 million
Major Trading Partners: Russia, Turkey, European Union, Azerbaijan, Armenia, United States (1997)
Merchandise Exports (2000E): $465 million
Merchandise Imports (2000E): $1.021 billion
Merchandise Trade Balance (2000E): -$556 million
Major Exports: citrus fruits, tea, wine, other agricultural products; diverse types of machinery and metals; chemicals; fuel re-exports; textiles
Major Imports: fuel, grain and other foods, machinery and parts, transport equipment
Foreign Exchange Reserves (2000E): $110 million
External Debt (9/00E): $1.49 billion

ENERGY OVERVIEW

Minister of Fuel and Energy: David Mirtskhulava
Proven Oil Reserves (1/1/2001E): 35 million barrels
Oil Production (2000E): 2,200 barrels/day (bbl/d)
Oil Consumption (2000E): 23,000 bbl/d
Net Oil Imports (2000E): 20,800 bbl/d
Refining Capacity (1/1/2001E): 106,000 bbl/d
Natural Gas Reserves (1/1/2001E): 300 billion cubic feet (Bcf)
Natural Gas Production (1999E): 2.1 Bcf
Natural Gas Consumption (1999E): 41 Bcf
Coal Production (1999E): 11,000 short tons
Coal Consumption (1999E): 15,000 short tons
Electric Generation Capacity (1999E): 4.4 gigawatts
Electricity Generation (1999E): 8.0 billion kilowatt-hours (Bkwh)
Electricity Consumption (1999E): 7.1 Bkwh

ENVIRONMENTAL OVERVIEW

Minister of Environmental Protection & Natural Resources: Nino Chkhobadze
Total Energy Consumption (1999E): 0.16 quadrillion Btu (0.04% of world total energy consumption)
Energy-Related Carbon Emissions (1999E): 1.6 million metric tons of carbon (0.03% of world carbon emissions)
Per Capita Energy Consumption (1999E): 28.7 million Btu (vs U.S. value of 355.9 million Btu)
Per Capita Carbon Emissions (1999E): 0.3 metric tons of carbon (vs U.S. value of 5.6 metric tons of carbon)

Energy Intensity (1999E): 34,402 Btu/$1990 (vs U.S. value of 12,638 Btu/ $1990)**
Carbon Intensity (1998E): 0.34 metric tons of carbon/thousand $1990 (vs U.S. value of 0.20 metric tons/thousand $1990)**
Sectoral Share of Energy Consumption (1997E): Residential (29.2%), Industrial (26.0%), Commercial (25.1%), Transportation (19.8%),
Sectoral Share of Carbon Emissions (1997E): Transportation (36.4%), Industrial (35.3%), Residential (17.1%), Commercial (11.4%)
Fuel Share of Energy Consumption (1999E): Oil (31.9%), Natural Gas (39.8%), Coal (0.1%)
Fuel Share of Carbon Emissions (1999E): Oil (59.9%), Natural Gas (25.0%), Coal (0.4%)
Renewable Energy Consumption (1997E): 64 trillion Btu* (7% increase from 1996)
Number of People per Motor Vehicle (1997): 11.6 (vs U.S. value of 1.3)
Status in Climate Change Negotiations: Non-Annex I country under the United Nations Framework Convention on Climate Change (ratified July 29th, 1994). Ratified the Kyoto Protocol on June 16th, 1999.
Major Environmental Issues: Air pollution, particularly in Rust'avi; heavy pollution of Mtkvari River and the Black Sea; inadequate supplies of potable water; soil pollution from toxic chemicals
Major International Environmental Agreements:A party to Conventions on Air Pollution, Biodiversity, Climate Change, Climate Change-Kyoto Protocol, Desertification, Endangered Species, Hazardous Wastes, Law of the Sea, Ozone Layer Protection, Ship Pollution, Wetlands. Has signed, but not ratified: none of the aforementioned agreements.

* The total energy consumption statistic includes petroleum, dry natural gas, coal, net hydro, nuclear, geothermal, solar and wind electric power. The renewable energy consumption statistic is based on International Energy Agency (IEA) data and includes hydropower, solar, wind, tide, geothermal, solid biomass and animal products, biomass gas and liquids, industrial and municipal wastes. Sectoral shares of energy consumption and carbon emissions are also based on IEA data.

**GDP based on EIA International Energy Annual 1999

ENERGY INDUSTRIES
State Oil Company: Saknaftobi Saknavtobproductebi (Georgian Oil Products), Saknakhshiri (Georgian Coal), Sakenergo (Georgian Energy), Saknaftobi (Georgian Oil)
State Joint Stock Company: Georgian Gas International Corporation (GIC)
Major Oil and Gas Fields: None; small fields in both eastern Georgia and on the Black Sea shelf in western Georgia.
Major Pipelines: 100,000 bbl/d Supsa-Baku (Azerbaijan) oil pipeline; Grozny (Russia) to Tbilisi (Georgia) to Yerevan (Armenia) gas pipeline.
Refineries (crude oil capacity): Batumi (106,000 bbl/d), Georgian-American Oil Refinery (Sartichala) (4,000 bbl/d)
Major Ports: Supsa, Batumi, Poti, Sukhumi
State Electric Utilities: Sakenergo-Generatsia (Generation) and Sakenergo-Gadatsema (Transmission)
Major Power Plants (capacity): Inguri hydroelectric plant (1325 megawatts, MW), Tbilisi State Regional Power Plant (Gardabani) (1280 MW)

Sources for this report include: CIA World Factbook 2000; U.S. Department of Commerce's Business Information Service for the Newly Independent States (BISNIS); Economist Intelligence Unit ViewsWire; U.S. Energy Information Administration; Oil and Gas Journal; Petroleum Economist; Radio Free Europe/Radio Liberty; Reuters; WEFA Eurasia Economic Outlook.

Links

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Links to other U.S. government sites:
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U.S. Department of Commerce's Business Information Service for the Newly Independent States (BISNIS):

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File last modified: April 9, 2001

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